American Airlines
Federal Credit Union

March 26, 2009

Mary F. Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

RE: Comments on Advanced Notice of Proposed Rulemaking for Part 704

Dear Ms. Rupp:

I am the Senior Vice President and Chief Financial Officer for American Airlines Federal Credit Union (AA Credit Union). AA Credit Union has over $5 billion in assets, is the ninth largest credit union in the United States and has over 212,000 members located throughout the United States. I am writing in response to the request for public comment regarding the advanced notice of proposed rule making (ANPR) for 12 CFR Part 704 concerning corporate credit unions issued by the National Credit Union Administration (NCUA).

Corporate credit unions have been an important provider of diverse services to many credit unions and an important group of institutions that should be maintained in our cooperative. The severe market dislocations being experienced worldwide have had an impact on the financial situation of many institutions including corporate credit unions. Many lessons can be learned from the current dislocation and we commend NCUA for gathering comments on how to improve the operational and regulatory structure of corporate credit unions. Our comments will address the major aspects of the restructuring for which NCUA solicited comments.

<u>Payment Systems</u>
It would be a mistake to further fragment the corporate system into functional areas. It can probably be argued that the corporate credit union system is already too fragmented since there are 28 corporate credit unions. It appears that there is room for consolidation which will drive efficiencies as well as facilitate oversight. Separating payment services will create the need for additional overhead and might create inefficiencies. Establishing a separate charter for a narrow field of services is an unnecessary constraint with no apparent benefit. Alternatively, payment services could be protected by placing them under a sheltered wholly owned subsidiary of each corporate.

<u>Liquidity and Liquidity Management</u>
Corporate credit unions are an important source of liquidity to credit unions and have internal liquidity needs that must be adequately addressed in any restructuring. The liquidity needs of natural person credit unions are varied. Some credit unions borrow to sustain rapid loan growth while others have ample capacity to lend. At year-end 2008, credit unions had over $36 billion in borrowings and a total asset base of $813 billion.

Corporate credit unions were providing over $6 billion of loans to credit unions, so they are an important liquidity provider. Although credit unions have access to other sources of liquidity beyond the corporates, it is best to preserve diverse sources of liquidity, particularly in these times of financial stress. As an industry, we should maintain the flexibility of having a liquidity source from within our cooperative movement. The corporates are also an important liquidity provider to smaller credit union that are likely unable to access other sources of liquidity such as the Federal Home Loan Bank.

Corporates are currently experiencing a liquidity crisis themselves because they did not have adequate backstops, such as the ability to borrow directly from the Central Liquidity Fund (CLF) and because deposits were not federally guaranteed. Any restructuring should include legislation that provides corporates access to the CLF and guarantees deposits in corporates. From year-end 2007 to year-end 2008, natural person credit union investments in corporates declined from nearly $35 billion to $28.7 billion. This drain of over $6 billion dollars in liquidity for the corporates could only have aggravated their financial strain. Had a full federal guarantee of deposits in corporate credit unions been in place, this drain in funding likely would have been much smaller. Any restructuring should maintain a federal guarantee that is <u>directly funded by corporates</u>.

<u>Field of Membership Issues</u>
Two important goals should be met when restructuring the corporate credit unions and their services:

- Reduce the number of corporate credit unions so that each has sufficient size to achieve significant cost efficiencies through economies of scale
- Preserve a sufficient number of corporate credit unions that will maintain healthy competition, while providing some redundancies (for disaster recovery)

It is commendable that NCUA has asked for comments from interested parties before dictating new regulations. However, the replies that NCUA will receive to this ANPR will likely be very diverse and polarized. Rather than immediately issuing new rules, the NCUA should form a working group composed of natural person and corporate credit unions as well as trade organizations that will develop the redesigned corporate credit union model using the comments received from this ANPR. We need to be careful about not over reacting and moving to an extreme restrictiveness or an inflexible structure. This is an opportunity to find greater efficiencies within the corporates and within the credit union movement.

A way of achieving this consolidation could be to set a date by which the corporates must essentially be "re-chartered" by presenting a business plan that includes geographic coverage, services to be offered and pricing. A limited number of new charters should then be granted, based on ability to offer services, price competitiveness and other qualifications. Credit unions should be free to contract for services with any corporate without geographic or membership requirements. This competition will ensure that each corporate provides competitive and quality products and services, at the lowest cost.

A lesser number of larger corporate credit unions will have better negotiating leverage for services they contract, which will result in lower prices of services for all credit unions. The scale provided through fewer but larger corporate credit unions will enable them to offer a wider array of services and will generate greater non-interest income. Growth in non-interest income will reduce reliance on investment income and the associated incentive to make riskier investments.

Consolidation of the corporate credit unions will also facilitate regulatory supervision by allowing NCUA to focus on a fewer number of institutions.

In the period before the official "re-chartering", corporate credit unions should be incented to merge, cooperate, consolidate resources, achieve greater efficiencies and even offer additional service through increased collaboration. This will provide a rational and orderly process for consolidating the operations and resources of the 28 corporates. The corporates that are not awarded a new charter will either merge, be acquired, or cease to operate.

An example of what can be achieved through these economies of scale and consolidation can be seen in the Des Jardines model practiced by Canadian credit unions in Quebec province. The Des Jardines "corporate" is a central provider of services ranging from investments, liquidity, payment systems, core systems and many other services. The Desjardin model in Canada has allowed both very large and small credit unions to thrive. This is not to suggest that we mimic the Desjardins model, but rather it is an example of the benefit that can be achieved through consolidation and economies of scale. It has been said that to survive as a movement, credit unions must have deeper collaboration and share resources that achieve greater economies of scale. This is clearly an opportunity to reinvent the support structure provided through the corporates and to achieve such efficiencies

Expanded Investment Authority

The expanded investment authority should be maintained, but with more restrictions that reduce the risk profile of investments. If a corporate is not granted expanded authority, it would make it very difficult for them to generate spread income and therefore pass on value to those that invest in corporate credit union certificates.

Some have argued that the corporates are not needed as a source of investments for natural person credit unions, but again if they can generate value while controlling risk, they should be preserved as a source of investment for credit unions within our cooperative. As with policies that natural credit unions must follow, investment restrictions should include requirements for thorough and regular credit analysis, concentration limitations and a listing of prohibited risky investments.

A restriction should be placed on corporates' ability to leverage. Corporates have an average loan to asset ratio of just over 8%, yet they had borrowings of $32 billion at year-end 2008. Generally, those corporate credit unions that have the highest leverage are the ones that are having problems with risky investment and insufficient capital.

Structure: 2-Tiered System

A two tier structure could be effectively employed to isolate and standardize the core investment function. A central corporate could be the only entity with expanded investment authority. Time deposits in a central corporate would be made available only to all other corporate credit unions. These central time deposits could be the only allowable "investment" for the non-central corporates. Offering rates would be uniform and vary only by term.

The time deposits from corporates would be held by the central corporate and invested in more complex investments. The central corporate could then manage one central portfolio which is easier to regulate and audit. An investment advisory committee for the central corporate should be composed of the existing investment experts from each corporate and from natural person credit unions.

Each corporate could still offer its own term deposits to natural person credit unions at whatever rate it chose. The corporates' ability to offer premium deposit rates to natural person credit unions would be driven by two things: their level of efficiency and their ability to generate non-interest income through services. This structure would eliminate the need for corporates to take unnecessary investment risk or excessive leverage, but will preserve the investment expertise that currently exists at each corporate. In a sense they would strictly act as investment advisors to the central corporate.

The deposits from natural person credit unions in each individual corporate should be federally guaranteed. Earnings from the central corporate would first go to build capital at the central corporate and any surplus would be distributed to the individual corporates. Each individual corporate should have direct access to the CLF and other sources such as FHLB, but could only leverage to provide liquidity for internal operations and for natural person credit unions. Leverage should not be permitted for funding investments.

Corporate Capital

The capital of a corporate must be risk-based and higher minimums should be established. A key question that still exists is what to do with the impaired assets of the existing corporates. Under the proposed re-chartering, the toxic assets can be isolated in the existing corporates until they are paid off or consolidated into a temporary holding entity that buys the existing corporates. Those assets not considered toxic and that are not subject to significant mark to market losses can be sold to the new central corporate.

The GAP requirement of mark-to-market accounting is something that must be complied with, however by isolating the toxic assets the NCUA could now establish new capital requirements for the toxic entity that are based on true net realizable value rather than distressed sale prices. The net realizable value would be based on an outside analysis that determines true expected cash flows from the underlying collateral and projected losses experienced by the underlying collateral.

Membership Capital

Each individual corporate should be required to contribute capital to the new central corporate. The individual corporates could be capitalized through optional credit union capital investments, third party capital and through retained earnings. As when contracting with most other service providers, natural person credit unions should not be required to contribute capital in order to purchase services or to invest in deposits at the individual corporates. Such a requirement could have the unintended consequence of encouraging credit unions to move services to providers that do not require higher-risk capital investments as a condition of contracting services.

Credit Risk and Asset Liability Management (ALM)

We must learn from the current crisis and strengthen credit review requirements, concentration limitations and restrictions on leverage investing. It's easy to look in the rear view mirror and see what went wrong, but we should not overreact by placing extreme restrictions on investment activities of the central corporate. Many qualified investment professionals have been very surprised at the severity of the current crisis.

Some argue that the "market value" of many securities is understated when compared to the fundamental value of the underlying collateral using expected defaults and loss severity as well as applicable credit support.

Generally, new guidelines should focus on the process that must be followed to ensure proper due diligence and regular credit monitoring is followed by the corporates. Clearly the rating agencies missed a lot in their ratings and hopefully have tightened standards, but sole reliance on their assessment is risky. Requiring ratings from multiple rating agencies could help, but must also include thorough independent credit analysis.

The central corporate should be required to follow the same stress test and ALM modeling that is required of natural person credit unions. This seems like common sense.

Corporate Governance

The ANPR contains very detailed governance requirements, for which it is difficult to judge appropriateness without more information or without having the new structure defined. Whatever the new structure, it should require that corporates have adequate representation from natural person credit unions on their board of directors. Many credit unions have excellent board governance as well as management practices that can be shared in a board capacity.

If you look at the board members of many of the corporates, they are already composed of very qualified individuals, so it appears that the greatest benefit would come from requiring boards to have broader representation and have them ensure key processes, monitoring and controls are being followed. Establishing minimum training standards would also be appropriate. Matters such as board compensation should be determined by each individual corporate.

Thank you for all of your diligent efforts on this ANPR. We appreciate the opportunity to comment on this matter. If you have any questions, please call me at 817-967-6868.

Sincerely,

Eli Vazquez
Senior Vice President & Chief Financial Officer

cc: A. Owens
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NAFCU